

ST 03-13

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE, as responsible
officer of ABC Apparel, Inc.,
Taxpayer**

**No. 02-ST-0000
NPL No. 0000
IBT No. 0000-0000**

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. John Doe appearing *pro se*; Mr. Marc Muchin, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to John Doe's protest of Notice of Penalty Liability No. 0000 (hereinafter the "NPL") as responsible officer of ABC Apparel, Inc. (hereinafter "ABC"). The NPL represents a penalty liability for Retailers' Occupation Tax of ABC due to the Department for various months during the period October, 1998, through December, 1999. A hearing was held in this matter on May 16, 2003, with Mr. John Doe, Ms. Jane Doe (John Doe's sister), and Mr. Joe Blow providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that the NPL issued against Mr. Doe be finalized as issued. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. 0000, which shows a penalty for tax liability of ABC in the amount of \$24,703.98, including interest calculated through September 7, 2000. The NPL covers various months during the period October, 1998, through December, 1999. Tr. pp. 8-11; Dept. Ex. No. 1.
2. ABC's "NUC-1 Illinois Business Registration," lists John Doe as "secretary," Mr. Smith as "vice president," Mr. Jones as "president" and Joe Blow as "treasurer." On question 14 of the form, Mr. Doe accepted "personal responsibility for the filing of returns and the payment of taxes due." Mr. Doe signed the "Signature Affidavit" in Section 7 of the NUC-1. Tr. pp. 14-16; Taxpayer's Ex. No. 2.
3. Mr. Doe was secretary and co-manager, with Joe Blow, of ABC. Doe was employed from June of 1998 through March of 2000. He was on the premises on a day-to-day basis. ABC, located at in Anywhere, sold retail clothing. Tr. pp. 16-17, 19-20.
4. The "Sales and Use Tax Returns" for ABC for the period October through December, 1999, were signed by John Doe. Doe signed checks to pay bills that were due. Tr. pp. 17-19; Department's Ex. No. 2.
5. John Doe was a signatory on ABC's account, number 0000000000, at Bank. On March 14, 2000, Jones and Smith signed a "checking closeout withdrawal" on this account and withdrew \$19,213.78. This check was made payable to Jones and deposited in his personal account at Bank, number 0000000000. Tr. pp. 32-35; Taxpayer's Ex. No. 1.

Conclusions of Law:

The sole issue to be decided in this case is whether Mr. Doe should be held personally liable for the unpaid retailers' occupation tax of ABC. The statutory basis upon which any personal liability is premised is Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section.
35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) "willfully" fails to file returns or make payments.

The admission into evidence of the NPL establishes the Department's *prima facie* case with regard to both the fact that Mr. Doe was a "responsible" officer and the fact that he "willfully" failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the presumption of liability through sufficient evidence that the person was either not a responsible officer or employee, or that his actions were not willful. *Id.*

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that John Doe was a responsible party under the statute. Mr. Doe testified at the evidentiary hearing that he was a secretary of ABC. Tr. p. 16. Mr. Doe admitted that he signed the “NUC-1, Illinois Business Registration” as “secretary” and accepted “personal responsibility” for the filing of returns and payment of taxes due in question 14 of the form. Tr. p. 16. Mr. Doe, as “secretary,” also signed Section 7, the “Signature Affidavit” on the “NUC-1.” This Section is signed “under penalties of perjury” and is an attestation that the “NUC-1” is “true, correct and complete.” Taxpayer’s Ex. No. 2.

Mr. Doe argued during the evidentiary hearing that his signature on the NUC-1 does not make him “the responsible party as far as paying the taxes of ABC Apparel.” Tr. p. 15. “When getting your license, it’s really you have no choice but to sign that.” Tr. p. 14. “If I did not sign that, of course, we could not have had the business. You must fill this out in order to have your business.” Tr. p. 79. The language of question 14 is not meant to expand the personal liability of corporate officers or employees and it does not make them personal guarantors of a corporation’s tax liability under all circumstances. Question 14 must be read in conjunction with Section 3-7 of the Uniform Penalty and Interest Act (35 ILCS 735/3-7) because the question seeks to identify those persons who have the responsibility for filing returns and paying taxes. It is only if those

persons are found to have willfully failed to file returns or pay taxes that they can be held personally liable. Gen. Info. Letter, ST-96-0326. If Mr. Doe was unsure of the consequences of signing the NUC-1, he should have solicited legal advice prior to signing. Mr. Doe's signature on question 14 of the NUC-1 is evidence of his status as a corporate officer of ABC with the responsibility for filing tax returns and payment of sales taxes.

Further evidence of Mr. Doe's responsibility for the filing of returns and payment of taxes is his signature on the "Sales and Use Tax Returns" for ABC for the months of October through December, 1999, included in the period covered by the NPL. Department Ex. No. 2. With regard to the payment of the taxes, Mr. Doe testified as follows:

As far as the accounts and taxes being paid, I would get a call from the accountant. The accountant would send in the paperwork for the taxes. The only thing the accountant would say is to sign it and send it out because if you didn't sign it, you still would be penalized for not sending it in.

Tr. p. 31.

Mr. Doe did not call the accountant as a witness at the evidentiary hearing. Mr. Blow, treasurer of ABC and co-manager of the store with Mr. Doe, did not mention the accountant when testifying about the payment of sales tax. Mr. Blow was asked if he and Mr. Doe paid sales tax. He responded:

Anyway, we did pay a sales tax at one time just so we could stay current. I mean it wasn't like we were trying to beat the system or anything. You know, we knew we had to pay it. That's how a lot of businesses go under from not paying sales taxes.

Tr. p. 70.

Mr. Blow testified further that at one time he and Mr. Doe paid a lump sum of \$4,000 in sales taxes to the Department of Revenue and after that, they were "supposed to be set on a payment plan." He testified that he and Mr. Doe negotiated with the Department, "[B]ecause that's how we came up with the first sum of money that we paid them." Tr. p. 71. Mr. Doe's signature on the "Sales and

Use Tax Returns” and the fact that he was negotiating on behalf of ABC with the Department of Revenue clearly indicate that he had significant control over the business affairs of ABC. Monday, *supra*.

Another indication of Mr. Doe’s responsible position with ABC was his ability to sign corporate checks. In a letter from Mr. Doe, dated July 18, 2002, requesting information from Bank regarding ABC’s account, number 0000000000, he stated “[I] was a signatory on the account prior to its closing.” Taxpayer’s Ex. No. 2. Mr. Doe testified that his “duties [were] to go in, open the store on a day-to-day basis and...make sure the bills [were] paid. I paid the bills on behalf of the owners.” Tr. p. 31. “The only time I paid bills was when I called the owner and asked the owner, can we pay this bill? They would check to see if the monies [were] available. I would pay the bills.” Tr. p. 31. Mr. Blow was asked if he and Mr. Doe “wrote out checks for, to pay the rent or the electric bill or the insurance?” He responded: “Whatever we had to pay, whatever to pay, creditors or whatever. Whatever needed to be, we had to write.” Tr. pp. 65-66.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473 (E.D.N.Y. 1981), aff’d, 671 F. 2d 492 (2d Cir. 1982). Although Mr. Doe testified that he paid bills only after he called the owner, there was no testimony or evidence that the owner’s signature was required on the checks. Regardless of the circumstances under which Mr. Doe paid the bills, each time he signed a check, he participated in “decisions regarding the payment of creditors and the disbursement of funds,” evidencing his status as a responsible party. Monday, *supra*. As a signatory on the corporate bank account, Mr. Doe could have unilaterally written a check to the State of Illinois for sales taxes.

Mr. Doe introduced as evidence at the hearing a letter that he had written to Bank requesting information regarding ABC's account, number 0000000000. Bank's response to this letter indicates that on March 14, 2000, Mr. Smith and Mr. Jones, who are listed as vice-president and president, respectively, on the NUC-1, and who Mr. Doe refers to as ABC's "owners," signed a "checking closeout withdrawal" on the above account and withdrew \$19,213.78. The check was made payable to Jones and deposited in his personal account at Bank, number 0000000000. Tr. p. 29; Taxpayer's Ex. No. 1. According to Mr. Doe, this shows that Jones and Smith were "the principal parties on this account and they are the persons who opened the account and they are the persons who closed the account and took the monies out of the account at the close of the checking account." Tr. p. 35.

Doe did not call either Smith or Jones as witnesses at the evidentiary hearing although Mr. Blow testified that he has seen Smith "from time to time." Tr. pp. 67-68. Mr. Doe's argument appears to be that Smith's and Jones's withdrawal of the \$19,213 remaining balance from ABC's bank account is evidence of their responsibility for the unpaid taxes. Although the withdrawal indicates that Smith and Jones shared control over the bank account with Doe, this does not make Doe less of a "responsible" officer. The statute does not confine liability to only one person or to the person most responsible. Mr. Doe was a signatory on the bank account. There was \$19,213 remaining in the account when ABC went out of business. ABC's unpaid taxes to the State of Illinois, exclusive of penalty and interest, were \$17,903. Mr. Doe was an authorized signer and could have written a check on the Bank account to cover the unpaid taxes.

In order to overcome the Department's *prima facie* case, evidence must be presented which is consistent, probable and identified with the corporation's books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). When the Department established it's

prima facie case, the burden shifted to Mr. Doe to overcome the presumption of responsibility through sufficient evidence. Branson, *supra*. The only documentary evidence offered by Mr. Doe, the NUC-1 signed by him in which he accepted responsibility for the filing of returns and the payment of taxes and the letter to LaSalle Bank indicating that he was a signature on ABC's bank account, are not sufficient to overcome the Department's *prima facie* case. Without any other documentary evidence to support his contentions in this case, Mr. Doe has failed to rebut the Department's presumption that he was a responsible party under the statute.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept. of Revenue, 168 Ill. 2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness. 35 ILCS 735/3-7 fails to define what constitutes a willful failure to file or pay taxes. In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have adopted a broad interpretation of the words "willfully fails." Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Willfulness includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the government." Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). A person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985). "Willfulness" as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970).

Mr. Doe's conduct was willful under each of the above benchmarks. Mr. Blow testified that he and Mr. Doe paid a lump sum of \$4,000 in late sales tax to the Department and "after that we

were supposed to be set on a payment plan.” Tr. p. 71. Mr. Blow stated further that after the payment plan, “to be totally honest with you, I don’t know where it went from there. I don’t know.” Tr. p. 71. Mr. Doe obviously knew that ABC was delinquent in sales taxes and that taxes were not being remitted to the State. At any time after paying the lump sum to the Department and negotiating the payment plan, Mr. Doe, as an authorized signature on the bank account, could have unilaterally written a check to the State to cover the delinquent taxes. There was no documentary evidence or testimony that Mr. Doe either tried to pay the late taxes or took any positive steps to ensure that taxes would be paid. I conclude, therefore, that Mr. Doe acted willfully in failing to investigate and correct ABC’s mismanagement, when he, in fact, had the power to correct it, after having notice that taxes were not being remitted. If a responsible person does nothing, despite being on notice of a grave risk of nonpayment, a finding of willfulness is justified. Branson, *supra*.

Mr. Blow testified that when a sale was made to a customer, the sales tax was recorded on the cash register and he and Mr. Doe used a ledger to record daily sales and taxes. Tr. p. 61. According to Mr. Blow, “all we did was basically, you know, just deposit money.” Tr. p. 60. I presume from this testimony that sales tax was collected from customers and that some of the money deposited into ABC’s bank account was the sales tax collected. At the time that ABC went out of business, delinquent sales taxes totaled \$17,903 and there was \$19,213 remaining in the corporation’s bank account at Bank. The funds remaining in the bank account belonged to the State. As a signatory on this account, Mr. Doe could have written a check for the delinquent taxes. Mr. Doe was aware of the fact that taxes were delinquent, yet still allowed \$19,213 to accumulate in ABC’s bank account. In doing so, Mr. Doe showed a reckless disregard for the risk that the

funds would be used for other purposes and not be remitted to the State, further evidencing willfulness. Monday, *supra*.

Finally, when Mr. Blow was asked whether he and Mr. Doe wrote out checks to pay the rent, electric bill, and insurance, he responded “[W]hatever needed to be [paid], we had to write. Tr. p. 66. When asked about his and Mr. Doe’s salary, Mr. Blow testified “[W]e...were able to sometimes pay ourselves something when we needed to pay bills.” Tr. p. 63. Neither Mr. Blow nor Mr. Doe testified that any creditors were left unpaid. Without any testimony or documentary evidence as to the payment of creditors, and knowing that the State was not paid its sales taxes, I must conclude that other creditors were preferred over the State further showing willfulness on Mr. Doe’s part. Accordingly, Mr. Doe has failed to rebut the Department’s prima facie presumption that he willfully failed to pay ABC’s sales taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000 be finalized as issued.

August 14, 2003

Kenneth J. Galvin
Administrative Law Judge